

BEFORE THE DEPARTMENT OF CORPORATIONS
OF THE STATE OF CALIFORNIA

In the Matter of the First Amended
Accusation By:

OAH No. 2010100340

THE CALIFORNIA CORPORATIONS
COMMISSIONER,

Complainant,

v.

KAREN GARDNER,

Respondent.

PROPOSED DECISION

Howard W. Cohen, Administrative Law Judge (ALJ) in the Office of Administrative Hearings (OAH), heard this matter in Los Angeles on June 22, 2011.

Joanne Ross, Corporations Counsel, Enforcement Division, Department of Corporations (Department), appeared on behalf of complainant Preston DuFauchard, California Corporations Commissioner (complainant or Commissioner).

No appearance was made by or on behalf of respondent Karen Gardner.

Complainant requested that respondent's default be entered and that complainant be permitted to prove up the allegations set forth in the First Amended Accusation. This matter proceeded as a default under Government Code section 11520. Complainant presented oral and documentary evidence.

The record was left open until June 30, 2011, to allow complainant to submit the declaration of a witness originally scheduled to appear on the second day of hearing. The declaration was timely submitted and was marked and admitted into evidence as Exhibit 27.

The record was closed and the matter was submitted for decision on June 30, 2011.

FACTUAL FINDINGS

Jurisdiction

1. Complainant, in his official capacity, filed and served on respondent, by personal delivery at her residence address, a Notice of Intention to Issue Order Pursuant to California Financial Code Section 17423 (Bar From Employment, Management or Control of Any Escrow Agent), with an Accusation attached, on September 29, 2010.
2. Respondent timely filed a Notice of Defense, requesting a hearing and listing a post office box return address.
3. A Notice of Administrative Hearing reflecting a hearing date of November 2, 2010, was served on respondent at the post office address by mail on October 11, 2010.
4. On October 29, 2010, complainant amended the Accusation. A request by respondent that the November 2, 2010, hearing be continued was granted by OAH. An Amended Notice of Administrative Hearing reflecting new hearing dates of January 4 and 5, 2011, was served by complainant by mail to respondent's post office box address on November 15, 2010.
5. On December 29, 2010, respondent moved to continue the hearing dates; OAH granted the motion and set the hearing for June 22 and 23, 2011. A Second Amended Notice of Administrative Hearing reflecting the new hearing dates was served by complainant by mail to respondent's post office box address on January 13, 2011.
6. On March 11, 2011, respondent filed a motion to advance the hearing; OAH denied the motion on April 8, 2011.
7. On June 21, 2011, the day before the hearing was scheduled to commence, respondent moved to continue the hearing; OAH denied the motion on the same date.
8. Although complainant did not introduce into evidence certified mail receipts for service of notice of the hearing, respondent's several requests to continue or advance the hearing dates evidence her receipt of the notices of hearing and her knowledge of the hearing dates.
9. Findings 1 through 8 reflect that respondent's failure to appear at the hearing constituted a default. The hearing proceeded as a default prove-up.

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Respondent's Activities at Outlook Escrow, Inc.

10. Respondent was employed as an escrow officer at Outlook Escrow, Inc. (Outlook), an escrow agent licensed by the Department on May 14, 2003, from approximately February 15, 2007, through June 15, 2009.

11. On or about September 15, 2009, the Commissioner received a complaint regarding Outlook on an escrow handled by respondent. The complaint was from the sellers of real estate in Nevada alleging that respondent had mishandled the escrow.

12. Richard Malme, a Department corporation examiner, investigated the complaint. The escrow instructions and purchase agreement (collectively, the Agreement) relating to the Nevada property were executed on May 16, 2009. The Agreement stated that the buyer of the property was to deposit \$50,000 into an escrow account within five days from the date the Agreement was executed, and that the \$50,000 would be unconditionally released to the seller on June 15, 2009.

13. Respondent issued a "Proof of Funds" letter dated May 18, 2009, confirming that unencumbered funds totaling \$50,000 were in the escrow account. (Ex. 18, Tab D.) In fact, no funds had been deposited into the escrow account. (Ex. 18, Tabs G, H).

14. Mr. Malme then performed an examination of respondent's other activities at Outlook. Mr. Malme found an electronic mail sent to respondent from the president of a company called Kyburz Capital & Investments that stated that respondent should expect several calls to "verify POF" (proof of funds), and that instructed respondent as to the amount she should claim was held in escrow for each call. (Ex. 18, Tab L.) In fact, the escrow accounts were determined by Mr. Malme never to have held the claimed amounts.

15. Mr. Malme concluded that respondent had fraudulently issued a proof-of-funds notification, that she actively participated in a "conspiracy to defraud other parties as to the existence of trust deposits being held in escrow," and that she violated a provision of the Finance Code "by aiding and abetting the buyer in a materially misleading way and directly participating in a fraudulent misstatement of a material fact." (Ex. 18.) The president of Outlook terminated respondent's employment. (Ex. 18, Tab G.)

Respondent's Activities at First National Escrow

16. Respondent was employed as an escrow officer at First National Escrow (First National), an escrow agent licensed by the Department on December 24, 2001, from September 2009 to September 9, 2010.

17. The Commissioner directed that a special examination of the books and records of First National take place after receiving a complaint on March 23, 2010, about an escrow arranged by respondent.

18. During her examination of First National's records, Kitlin Chan, the Department's corporation examiner, reviewed the transaction identified in the complaint. Ms. Chan found that respondent had "issued false deposit statements, made unauthorized transfers of funds to and from unrelated escrows, did not follow escrow instructions and created a trust account shortage that amounted to \$1,862,914.28." (Ex. 23.)

19. The "Closing Instruction Letter" sent by the lender through its agent, Diversified Funding, Inc. (Diversified), on March 2, 2010, stated that \$400,000 was to be placed in escrow for "the two-part simultaneous closing that will take place in two separate transactions on or before March 2, 2010. If the closings do not happen within three business days of receipt of the funds, then you are instructed to return the principal amount of \$400,000.00 to: ORALABS, INC. . . ." (Ex. 21.)

20. The funds were received by First National on March 3, 2010. Respondent then made unauthorized transfers and disbursements from the escrow account. The closings did not take place within three business days of March 3; nevertheless, First National did not return the funds to OraLabs until almost two weeks later, on or about March 19, 2010, when it made only a partial repayment, all in direct violation of the lender's instructions. Denise Haack of Diversified testified at hearing that she believes no funds would have been repaid absent the efforts of the Department.

21. In September 2010, Ms. Chan performed an examination of respondent's other activities at First National. Ms. Chan found several violations of the escrow law involving different transactions.

22. In one of these transactions, lender Crown Financial, LLC (Crown) issued lender instructions dated June 10, 2010 (Crown Instructions). Item 7 of the Crown Instructions directed that the loan funds were to be returned immediately if the transaction did not close by June 18, 2010. Item 9 of the Crown Instructions specified that "Lifeway has no authority to give you any instructions whatsoever for disbursement of the Escrow Deposit except to return it to Crown." (Ex. 23.) Respondent, as well as Richard Tribe, the manager of Crown, and June Cox, the chief executive officer of the buyer, Lifeway Capital Group, Inc. (Lifeway), signed the instructions. (*Id.*)

23. On June 10, 2010, First National received \$224,000 from Crown. On the same date, respondent sent an email to June Cox, stating "ok just got the wire for \$224,000 where do I apply it." (Ex. 23, Tab 4.) Ms. Cox replied that respondent should "transfer \$51,919.77 from 10892kg to Pinehurst #10857 and the balance to 10821." (*Id.*)

24. Respondent proceeded to disburse the finds as Ms. Cox had instructed, in violation of the Crown Instructions. On June 10, 2010, respondent issued a check in the amount of \$51,919.77 from escrow number 10892KG to escrow number 19857KG. On June 11, respondent issued a check for the balance of \$172,080.23 from escrow number 10892KG to escrow number 19857KG.

25. In another transaction, on March 18, 2010, First National received \$1,500,000 from Bidamar Corporation and Shawbeth, Inc. (collectively, Shawbeth) that was credited to Shawbeth's escrow number 10808. On March 19, First National received an additional \$18,203.79 from Shawbeth.

26. On March 19, 2010, without authorization from Shawbeth, respondent transferred \$1,303,047.39 to escrow number 10807. Respondent then, again without authorization from Shawbeth, made multiple disbursements from escrow number 10807 in various amounts, including a wire transfer of \$420,595 to City National Bank to pay off an unrelated escrow.

27. Ms. Chan concluded that respondent had misappropriated escrow trust funds and made misstatements as to material facts pertaining to escrow accounts.

LEGAL CONCLUSIONS

1. The Commissioner may, after notice and opportunity for hearing, bar from any position of employment, management, or control any escrow agent, or any other person, if the Commissioner finds that the

bar is in the public interest and that the person has committed or caused a violation of this division or rule or order of the commissioner, which violation was either known or should have been known by the person committing or causing it or has caused material damage to the escrow agent or to the public.

(Fin. Code, § 17423, subd. (a)(1).)

2. Financial Code section 17414, subdivision (a)(1) and (2), provides that it is a violation for an escrow agent to:

(1) Knowingly or recklessly disburse or cause the disbursal of escrow funds otherwise than in accordance with escrow instructions, or knowingly or recklessly to direct, participate in, or aid or abet in a material way, any activity which constitutes theft or fraud in connection with any escrow transaction.

(2) Knowingly or recklessly make or cause to be made any misstatement or omission to state a material fact, orally or in writing, in escrow books, accounts, files, exhibits, statements, or any other document pertaining to an escrow or escrow affairs.

3. California Code of Regulations, title 10, section 1738 provides that all money deposited in an escrow account may be withdrawn or transferred to other accounts “only in accordance with the written escrow instructions of the principals to the escrow transaction” or pursuant to court order. Section 1738.2 requires that escrow agents use “property deposited in escrow only in accordance with the written escrow instructions of the principals to the escrow transaction . . . or . . . in accordance with sound escrow practice,” or pursuant to court order.

4. Cause exists to bar respondent from any position of employment, management, or control of any escrow agent under Finance Code section 17423, subdivision (a)(1), based on respondent’s violations of escrow instructions and unauthorized transfers and disbursements of funds placed in escrow in violation of Finance Code sections 17414, subdivision (a)(1) and (2), and California Code of Regulations, title 10, sections 1738 and 1738.2, as set forth in Factual Findings 10-27.

5. The escrow business is regulated and monitored by the Department to protect the public because, among other things, an escrow agent receives money in trust and holds it and distributes it for the benefit of others.

6. Based on the evidence in this matter, it is appropriate for the Commissioner to exercise his discretion to bar respondent from any position of employment, management, or control of any escrow agent.

ORDER

The Commissioner may bar respondent Karen Gardner from any position of employment, management, or control of any escrow agent.

DATED: October 21, 2011

HOWARD W. COHEN
Administrative Law Judge
Office of Administrative Hearings